Fujasa Property Sdn Bhd & Anor v Idaman Unggul Sdn Bhd & Anor

HIGH COURT (SHAH ALAM) — CIVIL SUIT NO 22NCVC-718–06 OF 2012
PRASAD ABRAHAM J
8 JANUARY 2014

Companies and Corporations — Shares — Dealing by company in its own shares — Whether company provided financial assistance to third party to buy its shares — Whether s 67 of the Companies Act 1965 infringed — Whether infringement would not adversely affect civil aspects of transactions but only exposed directors of infringing company to penal sanctions — Whether impugned transaction might be struck down if shareholders' and creditors' interests were materially prejudiced

This case concerned four agreements. In the first one between the second defendant ('D2') and Iktinuri Development Sdn Bhd ('Iktinuri'), D2 sold more than 70,000 of its shares in Fujasa Sdn Bhd ('Fujasa') to Iktinuri thereby giving the latter control over both Fujasa and the first plaintiff ('P1') and enabling it to commence construction work ('the project') on land belonging to P1. Under the first agreement, Iktinuri undertook to assume all liabilities of Fujasa. The second agreement was a joint-venture agreement between Fujasa and P1 making P1 the developer of the project. The third agreement was a settlement agreement between the defendants, Fujasa and Iktinuri to procure a settlement of Iktinuri's obligations under the first agreement. This was followed by a fourth settlement agreement between the defendants, Fujasa and P1 which was the subject of the instant action. The plaintiffs sought to declare the fourth agreement as null and void on the ground the consideration for the agreement breached s 67 of the Companies Act 1965 ('the CA'). Since the plaintiff chose to plead its case primarily on breach of s 67 of the CA, the pleadings related mainly to the assumption and settlement of liabilities set out in the first agreement. The defendants raised a counterclaim in the action.

Held, dismissing the claim and allowing the counterclaim:

(1) The court could not find any link to the agreements being tainted with illegality under s 67 of the CA in that Fujasa had granted financial assistance to Iktinuri for the purchase of its shares under the first agreement. The four agreements, which were made in contemplation of each other and had to be read together, showed commercial arrangements and adjustments being made by companies which were connected to each other and driven by the need to proceed with the development project (see para 11).

(2) The test was whether from the agreements Fujasa had granted financial assistance to either Iktinuri or the first defendant to buy shares owned in it by the second defendant. The four agreements and their terms and the evidence do not bear it out. Looking at the four agreements and their purport, the court found no financial assistance that infringed s 67 of the CA (see para 11).

(3) Even if s 67 had been infringed, it would not render the four agreements null and void but would only expose the directors of Fujasa to penal sanctions. The civil aspects of the transactions were preserved by the saving provisions of s 67 (see para 12).

(4) The court had to examine the facts of each case to see whether an impugned transaction materially prejudiced the interests of shareholders and creditors. In determining whether such prejudice had occurred, the court should take into account such factors as (i) whether the inherent prohibition identified a form of activity in which potential harm to the interests of the company and its shareholders and creditors was so high that it should be struck down (ii) the transaction would involve the company in diminution of resources or had the potential to do so (iii) the percentage impact on the company's financial position was large (iv) the transaction would damage the value of shareholders' or creditors' interests and (v) whether the justice of the case required the transaction to be struck down (see para 18).

[Bahasa Malaysia summary

Kes ini adalah berkenaan empat perjanjian. Dalam perjanjian pertama antara defendan kedua ('D2') dan Iktinuri Development Sdn Bhd ('Iktinuri'), D2 menjual lebih daripada 70,000 sahamnya dalam Fujasa Sdn Bhd ('Fujasa') kepada Iktinuri dan dengan itu memberikan Fujasa kawalan ke atas kedua-dua Fujasa dan plaintif pertama ('P1') dan membolehkan ia memulakan kerja-kerja pembinaan ('projek tersebut') ke atas tanah milik P1. Di bawah perjanjian pertama, Iktinuri berjanji untuk mengambil alih kesemua liabiliti Fujasa. Perjanjian kedua merupakan perjanjian usahasama antara Fujasa dan P1 melantik P1 sebagai pemaju projek. Perjanjian ketiga adalah perjanjian penyelesaian antara defendan-defendan, Fujasa dan Iktinuri untuk mendapatkan penyelesaian kewajipan-kewajipan Iktinuri di bawah perjanjian pertama. Ini diikuti dengan penyelesaian keempat antara defendan-defendan, Fujasa dan P1 yang merupakan subjek kepada tindakan ini. Plaintif-plaintif memohon untuk mengisytiharkan bahawa perjanjian keempat adalah batal dan tidak sah atas alasan bahawa balasan perjanjian melanggar s 67 Akta Syarikat 1965 ('AS'). Oleh kerana plaintif memilih untuk memplidkan kes khususnya atas pelanggaran s 67 AS, pliding-pliding yang khasnya berkenaan anggapan dan penyelesaian liabiliti-liabiliti yang ditetapkan dalam perjanjian pertama. Defendan-defendan membangkitkan satu tuntutan balasan dalam tindakan.

Diputuskan, menolak tuntutan dan membenarkan tuntutan balas:

(1) Mahkamah tidak dapat mencari apa-apa hubungan dengan perjanjian-perjanjian dicemari di bawah ketaksahan di bawah s 67 AS dalam mana Fujasa telah memberikan bantuan kewangan kepada Iktinuri bagi pembelian saham-sahamnya di bawah perjanjian pertama. Keempat-empat perjanjian tersebut, yang dibuat sebagai pertimbangan satu sama lain dan perlu dibaca bersama-sama, menunjukkan aturan komersil dan perubahan-perubahan dibuat oleh syarikat-syarikat yang berkaitan dengan satu sama lain dan didorong oleh keperluan untuk meneruskan dengan projek pembangunan (lihat perenggan 11).

(2) Ujian adalah sama ada perjanjian-perjanjian Fujasa telah memberikan bantuan kewangan sama ada kepada Iktinuri atau defendan pertama untuk membeli saham-saham yang dimiliki dalamnya oleh defendan kedua. Empat perjanjian tersebut dan terma-terma dan keterangan tidak mengeluarkannya. Melihat pada keempat-empat perjanjian dan tujuan mereka, mahkamah mendapati tiada bantuan kewangan yang melanggar s 67 AS (lihat perenggan 11).

(3) Jika pun s 67 telah dilanggar, ia tidak menjadikan keempat-empat perjanjian tersebut tidak sah dan batal tetapi hanya akan mendedahkan pengarah-pengarah Fujasa kepada hukuman-hukuman penal. Aspek-aspek sivil transaksi dikekalkan oleh peruntukan-peruntukan penyelamat s 67 (lihat perenggan 12).

(4) Mahkamah perlu memeriksa fakta setiap kes untuk melihat sama ada transaksi yang dipersoalkan memprejudis kepentingan-kepentingan pemegang-pemegang saham dan kreditor-kreditor secara material. Dalam menentukan sama ada prejudis telah berlaku, mahkamah perlu mengambil kira faktor-faktor seperti sama ada larangan inheren mengenal pasti satu bentuk aktiviti dalam mana potensi bahawa kepada kepentingan-kepentingan syarikat dan pemegang-pemegang saham dan pemiutang-pemiutang adalah tinggi dan ia harus dibatalkan; transaksi akan melibatkan syarikat mengalami penyusutan sumber-sumber atau mempunyai potensi sedemikian; peratusan impak ke atas kedudukan kewangan syarikat adalah tinggi; transaksi akan merosakkan nilai-nilai kepentingan pemegang-pemegang saham atau pemiutang-pemiutang; dan sama ada keadilan kes memerlukan transaksi kes dibatalkan (lihat perenggan 18).]

Notes

For cases on dealing by company in its own company, see 3(1) *Mallal's Digest* (4th Ed, 2013 Reissue) paras 991–995.

Cases referred to

Co-Operative Central Bank Ltd (In Receivership) v Feyen Development Sdn Bhd [1995] 3 MLJ 313, FC (refd)

Lori (M) Bhd (Interim Receiver) v Arab-Malaysian Finance Bhd [1999] 3 MLJ 81, FC (refd)

Legislation referred to

Companies Act 1965 s 67

CY Lio (Lio & Partners) for the plaintiff.
Mohaji (Shazwani with him) (Mohaji Hazury & Ismail) for the defendant.

Prasad Abraham J:

[1] The trial of this matter was concluded on the 27 September 2013 and was adjourned for delivery of judgment by the court pending the filing of written submissions by respective counsels for the plaintiff and the defendant. After considering the oral evidence led, and the documents tendered, the court dismissed the plaintiff's claim with costs and allowed the defendant's counterclaim with costs.

[2] Before dwelling into the facts of the case, the plaintiff's claim is essentially that the settlement and assignment agreement dated 30 August 2006, is null and void as the plaintiff pleads the consideration for same, breaches s 67 of the Companies Act 1965 ('the said Act'). The defendant denies that position. Let me first deal with the scope of the said section in general terms. I set out the said s 67 below:

> Section 67 Dealing by a company in its own shares, etc.
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> 1 Except as is otherwise expressly provided by this Act no company shall give, whether directly or indirectly and whether by means of a loan, guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase, deal in or lend money on its own shares
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> 2 Nothing in subsection (1) shall prohibit:
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> (a) where the lending of money is part of the ordinary business of a company, the lending of money by the company in the ordinary course of its business;
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> (b) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of or subscription for fully-paid shares in the company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or

for the benefit of employees of the company or a subsidiary of the company, including any director holding a salaried employment or office in the company or a subsidiary of the company; or

(c) the giving of financial assistance by a company to persons, other than directors, bona fide in the employment of the company or of a subsidiary of the company with a view to enabling those persons to purchase fully-paid shares in the company or its holding company to be held by themselves by way of beneficial ownership.

3 *If there is any contravention of this section, the company is, notwithstanding section 369, not guilty of an offence but each officer who is in default shall be guilty of an offence against this Act. Penalty: Imprisonment for five years or one hundred thousand ringgit or both*

4 Where a person is convicted of an offence under subsection (3) and the Court, by which he is convicted is satisfied that the company or another person has suffered loss or damage as a result of the contravention that constituted the offence, the Court may, in addition to imposing a penalty under that subsection, order the convicted person to pay compensation to the company or the person, as the case may be, of such amount as the Court specifies, and any such order may be enforced as if it were a judgment of the Court

5 The power of a Court under section 354 to relieve a person to whom that section applies, wholly or partly and on such terms as the Court thinks fit, from a liability referred to in that section, extends to relieving a person against whom an order may be made under subsection (4) from the liability to have such an order made against him

6 *Nothing in this section shall operate to prevent the company or any person from recovering the amount of any loan made in contravention of this section or any amount for which it becomes liable, either on account of any financial assistance given, or under any guarantee entered into or in respect of any security provided, in contravention of this section.*
(Emphasis added.)

[3] The mischief that the said section was legislated to address was the depletion of resources of a company in assisting another to purchase its own shares.

[4] It is a protection of a company's creditors and minority shareholders against manipulation of the company's financial resources in such a way that the company gives up value in exchange of an obligation or repayment on repayment on the part of the controller which may turn out to be worthless if the controller becomes insolvent. Looking at the said section as a whole it is clear the said section was enacted for the protection of company's funds and the interests of shareholders as well as creditors and I might add, the public generally.

[5] I now proceed to examine the transaction and the approach to be adopted which in my view, is that as suggested by the text Ford's *Principles of Corporations Law* (10th Ed) para 24.710 p 1213 and I quote:

> *Material prejudice to interests o shareholders and creditors*
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> Prior to the 1998 amendments, there was considerable uncertainty about a fundamental aspect of the financial assistance prohibition. If the purpose of the prohibition was to protect a company's resources and prevent them from being diminished, or diminished in value, by a transaction of Financial Assistance, then it would be logical to say that a company does not financially assist an acquisition of its shares unless the resources of the company are diminished or reduced in value. On the other hand, if the purpose of the prohibition is to identify a form of activity in which the potential to harm the interests of the company, its shareholders and creditors is so high that activity of that kind should be absolutely prohibited in a prophylactic way, then the prohibition should apply whenever activity of the prohibited kind occurs which facilitates an acquisition of shares. The former approach has been called the 'impoverishment' doctrine, though that title is potentially misleading because under this approach, the law will apply where the company undertakes an obligation which might lead to diminution of resources but might not, and the law will also apply to a transaction which involves conversion of a company assets into one of lesser quality (for example, where cash is converted into an unsecured loan without interest to the purchaser of shares). Both the 'impoverishment' and the 'facilitation' approaches are supported by lines of case law.

[6] Before dealing with the said settlement and assignment agreement, a chronology of the documentary trail has to be looked at. The trail begins when the second defendant entered into a share sale agreement dated 17 January 2006, which appears in the plaintiff's bundle of documents tendered in support of its submissions (pp 1–28), and also in the bundle of documents, and in the first agreement, the salient points to note are:

(a) it is between Idris Hydraulic Properties Sdn Bhd ('the vendor') and Iktinuri Development Sdn Bhd ('the purchaser');

(b) the vendor was the registered over of 70,000 shares in a company known as Fujasa Sdn Bhd and the sale of the said shares was one of the considerations of the first agreement;

(c) the price of share are stated in the recitals to the said first agreement;

(d) it is to be observed, the key to this first agreement is with purchaser now being in control of Fujasa Sdn Bhd, they are entitled to commence construction of units on the said land belonging to the first plaintiff, now controlled by the purchaser; and

(e) more importantly in cl 8.3 of the said first agreement the purchaser will assume all liabilities of the Fujasa Sdn Bhd set out in the said first

agreement (see p 25 of plaintiff core bundle of documents second schedule) amounting to RM31,3000,000.

[7] It is noted that first agreement was being driven by purely commercial interests ie the purchaser's right to develop the project through Fujasa Sdn Bhd and the land of the Fujasa Sdn Bhd after the purchase of the said shares and assumption of the Fujasa Sdn Bhd liabilities. The recitals 'Proposed Development' clearly bear that out. It is also observed that chief executive officer who signed the first agreement on behalf of the purchaser did not testify in court.

[8] On the 4 of May 2006, a joint venture agreement was entered into between the said Fujasa Sdn Bhd now controlled by the purchaser under the first agreement and the first plaintiff found at pp 29–45 of the plaintiff's core bundle of documents and again the clauses refer in the main to the development of the said project upon terms and conditions contained in the second agreement and Fujasa Property Sdn Bhd had been appointed the developer ('the first plaintiff'). The relevant clauses to be looked at are the recitals cll 2.1, 6.1, 6.2 cl 8, cl 9 of 11 and 14 of the second agreement. In essence the first plaintiff now was the developer of the said project.

[9] I now turn to the settlement agreement dated 30 August 2006 between the defendants, and Fujasa Sdn Bhd and Iktinuri Development Sdn Bhd ('IKDSB') ('the third agreement'). In cl C of the recitals of the third agreement, it sets out the purpose of the third agreement was to procure a settlement of IKDSB obligations under the first agreement. The relevant clauses to look at are cll 2.1 and the recitals to the same.

[10] We now come to the settlement agreement dated 30 August 2006, betweens the defendants, Fujasa Sdn Bhd and the first plaintiff and the subject of the declarations being sought by the plaintiffs to declare the same null and void ('the fourth agreement') the same is found in pp 58–67 of the plaintiff's core bundle tendered with their submissions (B1 pp 57–68).

[11] The plaintiffs claim that the fourth agreement runs afoul of the said s 67 of the Companies Act 1965 and should be declared null and void. It is the view of the court that all four agreements were made in contemplation of each other and all agreements must be read together and since the plaintiff has chosen to plead its case primarily on s 67 of the said Act, the pleadings relate mainly to the settlement and assumption of liabilities that was first set out in the first agreement. The court cannot find any link to the agreements being tainted with illegality under s 67 of the said Act in that Fujasa Sdn Bhd had granted financial assistance to IKDB for the purchase of shares under the first agreement. That in my view is the cruxt of s 67 of the said Act. The four

agreements show commercial arrangements and adjustments being made by companies who were connected to each other and driven by the need to proceed with the development project. The test is whether from the agreements, was financial assistance for either IDKP or the first defendant being granted by Fujasa Sdn Bhd to purchase the shares owned in it by the second defendant, the four agreements and its terms and the evidence do not bear it out. Looking at the four agreements and looking at the purport of all four agreements, I find no financial assistance infringing s 67 of the said Act. As to the arguments as to the effect of some of its terms, unfortunately that is not the pleaded case of the plaintiffs.

[12] In the alternative even it is found to have infringed the said s 67 of the Companies Act 1965, it would not render the four agreements null and void but it will expose directors of Fujasa Sdn Bhd to penal sanctions. The civil aspects of the transaction are preserved. The Federal Court in *Co-Operative Central Bank Ltd (In Receivership) v Feyen Development Sdn Bhd reported in* [1995] 3 MLJ 313 took this approach, where the court held:

> (2) Section 133 of the Act does not state that a guarantee entered into or any security given in contravention thereof is to be void, although criminal liability would be imposed on the official of the company concerned, and on the company itself, by virtue of s 369(1)(a) and 369(2) of the Act.
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> (3) However, s 133(5), which states that a company may recover the loan amount or any amount for which it becomes liable under any guarantee or security given contrary to the section, implies that notwithstanding that a guarantee or security may have contravened s 133(1), the company may incur civil liability under it and can have recourse against the director/borrower. In order for the company to be liable, the guarantee or security must be valid and enforceable.
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> (4) Section 133 was designed for the protection of the company, its shareholders and creditors from unlawful dissipation of its assets for the benefit of its directors and their associates. The court would not aid a company which sought to rely on its own breach to escape its obligations, unless that was what the clear language of the statute required.
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> (5) In this case, it was clear that the loan had been received by the chargor company and that its assets were not being depleted through misuse. In reality, the chargor company was seeking to avoid repayment of the loan and to get back its land free of the charges. To admit the defence of illegality would provide a windfall gain to the chargor company and defeat the purposive interpretation of s 133.
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> (6) Although the charge transactions did breach s 133(1) of the Act, no civil consequences flowed therefrom, ie no voidness or

unenforceability attached to the loan or the charges, having regard to the context and purpose of s 133(1), and especially the principle underlying s 133(5), which the trial judge failed to take into account or to give proper weight to.

[13] And also to the judgment of His Lordship Edgar Joseph JR FLJ as he then was in para H pp 329–330 of the report and I quote:

> We would go further and say that to admit the defence of illegality to defeat the chargee society's application to enforce the charges by way of an order for sale, would, in the words of Mason J (as he then was) in *Yango Pastoral* (at p 428), provide 'a windfall gain' to the chargor company and others in a similar position. In consequence, such a result would impose substantial hardship upon the chargee society for, in the words of Gibbs CJ in *Yango Pastoral* (at p 415, para 1):
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> > ... if a body corporate were unable to recover money that it has lent, it would be disabled from performing its own obligations, including those owed to its depositors. In those circumstances 'the avoidance of the contract would cause grave inconvenience and injury to innocent members of the public without furthering the object of the statute' (*Archbolds (Freightage) Ltd v S Spanglett Ltd* [1961] 1 QB at p 390; *Dalgety and New Zealand Loan Ltd v VC Imeson Pty Ltd* (1963) 63 SR (NSW) 998 at p 1004).
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> This court will not be astute to lend its aid to enable the chargor company to take advantage of its own default or wrong by relying on its own breach to avoid the charge transactions and thereby escape its obligations thereunder, unless this is what the clear language of the statute is thought to require (see for example, *Kasumu v Baba-Egbe* [1956] 3 All ER 266 at pp 271I-272A; [1956] 3 WLR 575 at pp 583-584.)
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> But, to apply s 133 to the present charge transactions so as to produce a result which would exempt the chargor company from the obligations incurred by it thereunder would be tantamount to applying it to commercial transactions which were free from the taint of corporate abuse which the section was designed to counter. However, we repeat, this is not a court of morals but a court of law and, if the counsel for the chargor company is correct in his contentions, he is entitled to succeed.
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> Fortunately, in our view, subs (5) of s 133 enables us to hold that a breach of subs (1) of s 133 does not have the result contended for by counsel for the chargor company, for the reasons hereinbefore mentioned. The case of *Co-operative Central Bank Bhd v Syarikat Bukit Tinggi & Ors* was, therefore, rightly decided by Mohamed Dzaiddin J (now a Federal Court judge) in favour of the chargee, on the ground of the effect of subs (5) of the Act. It follows, therefore, that the case of *Che Wan* was wrongly decided.
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> *To summarise, our conclusion is that accepting that the charge transactions did breach s 133(1) of the Act, no civil consequences flowed therefrom, that is to say, no voidness or unenforceability attached to the loan or the charge transactions, regard being had to the context and purpose of s 133(1)*, and especially the principle underlying s 133(5), as explained above, which regrettably the learned judge failed to take into account or

to give proper weight to, with the result that his judgment cannot stand. This appeal therefore succeeds, the judgment of the court.
(Emphasis added.)

[14] I also refer to the decision of the Federal Court in *Lori (M) Bhd (Interim Receiver) v Arab-Malaysian Finance* reported in [1999] 3 MLJ 81 where the court held in 2, 3, 4 and 5 and I quote:

> (2) The judge does not appear to have addressed the question whether a breach of s 67 has civil consequences in depth and this may well have been because he felt that he was bound by the decision of the Supreme Court in *Chung Khiaw Bank Ltd v Hotel Rasa Sayang Sdn Bhd* [1990] 1 MLJ 356 (see p 99F-G).
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> (a) The court finds it difficult to agree with the ex cathedra pronouncement of the Supreme Court that the scope of s 67(6) is confined to the protection of the company and no one else. Looking at the second limb of subs (6) of s 67, the Court considers that the section was enacted for the protection of the company's funds and the interests of shareholders as well as creditors and the general public. There is no valid reason why its operation should be limited only to enabling a company to recover loans granted by it (see pp 105D, 106C-D).
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> (b) The court in Chung Khiaw Bank was unduly swayed by certain English authorities. These English cases were really of little assistance since the relevant legislation on which they were decided did not contain a saving provision equivalent to our subs (6) of s 67 of the Companies Act. Yet another difference was that the prohibition under the relevant English legislation imposed criminal liability not only on officers of the company but also the company itself, whereas under our s 67, criminal liability is imposed not on the company but only on officers of the company (see p 106E-F); *Chung Khiaw Bank Ltd v Hotel Rasa Sayang Sdn Bhd* [1990] 1 MLJ 356 not followed.
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> (3) In so far as subs (6) of s 67 of the Companies Act enables any person to recover any moneys in respect of a security in contravention of the section, the subsection appears to be a statutory recognition of the rule in *Victor Battery Co Ltd v Curry's Ltd & Ors* [1946] Ch 242 wherein it was decided that an illegal security given by a company to finance the purchase of its own shares contrary to s 45(1) of the Companies Act 1929 (UK) (being the equivalent of our s 67(1) of the Act) was not avoided. The Court would add, however, that the Companies Act 1929 (UK) did not have a provision equivalent to our subs (6) of s 67. It follows that even if Victor Battery was wrongly decided, it matters not for the principle enunciated therein has been statutorily recognised in subs (6) of s 67 (see p 107F-G).
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> (4) In *Chung Khiaw Bank Ltd v Hotel Rasa Sayang Sdn Bhd* [1990] 1 MLJ 356 as a result of the court failing to actually construe the five words 'for which

it becomes liable' in subs (6) of s 67, the court took a wrong turning and placed undue stress on the provisions of s 24 of the Contracts Act 1950 and held that because the bank had knowledge of the illegality and the nature of the transaction at the material time, the bank's claim failed. In the present court's view, s 67(6) creates an important exception to s 24 of the Contracts Act 1950 by allowing recovery under an illegal contract, thereby excluding the operation of s 24. In a situation where a company obtains a loan from a financial institution on the security of a charge over its land for the purpose of enabling an intending purchaser to purchase shares of the company, the company's liability to the financial institution both in respect of the loan and the security remains unaffected, having regard to the saving provision in the second limb of subs (6) of s 67 of the Companies Act. Consequently, the appellant's allegations, even if true, would not provide the existence of 'cause to the contrary' within the meaning of s 256(3) of the National Land Code (see pp 107H-108F).

(5) Having regard to the circumstances of the case as a whole, the grounds upon which the interim receiver and Mr Augustine were ordered personally to pay costs incurred, could be disputed. The fact that they had relied on professional legal advice in opposing the originating summons is a factor, which should have told in their favour rather than against. Both the orders requiring the interim receiver and Mr Augustine to be personally liable for costs in respect of the relevant portion of the proceedings are set aside (see p 109C-E).

[15] And to the leading of judgment of Edger Joseph JR FCJ in the case *Lori (M) Bhd (Interim Receiver) v Arab-Malaysian Finance Bhd* reported [1999] 3 MLJ 81 104–105 and I quote:

... The General Rule at Common Law

It is well settled that at Common Law, a contract or transaction in breach of a statutory prohibition and an associated contract is, in general, void for illegality even though the statute is silent as to its consequences and merely inflicts a penalty on the wrongdoers (See Menaka v Lum Kum Chum (ibid), at p 94, Phoenix General Insurance Co of Greece SA v Administratia Asigurarilor de Stat (ibid)) but this is subject only to any contrary intention manifested by the statute (see Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd (ibid)).

The next topic to be logically considered is the key issue: whether subs (6) of s 67 of the Act excludes the operation of s 24 of the Contracts Act?

Does subs (6) of s 67 of the exclude the operation of s 24 of the Contracts Act?

It will be recalled that in Chung Khiaw Bank, the submission advanced by counsel for the Bank that the effect of the second limb of subs (6) of s 67 of the Act, which provides that the section shall not operate to prevent the company from recovering 'any amount for which it becomes liable' and therefore the company's liability to third parties remains unaffected by the prohibition in the section, was rejected by the Supreme Court solely on the assumption that the scope of subs (6) of s 67 was confined to the protection of the company and no one else. Having so held, perhaps

understandably, the court made no attempt to actually construe the all-important five words 'for which it becomes liable' appearing in the subsection.

With respect, we find it difficult to agree with the ex cathedra pronouncement of the Supreme Court that the scope of subs 6 of s 67 is confined to the protection of the company and no one else for it is flatly contradicted by a wealth of respectable authority. It will suffice if we refer to just a few of these cases.

In *Wallersteiner v Moir* [1974] 3 All ER 217 at p 255 Scarman LJ (as he then was) held (at p 255A) that the section (s 54 of the Companies Act 1948, the counter part of our s 67) must have been enacted to protect the company funds and the interests of shareholders as well as creditors.

In *Skelton v South Auckland Blue Metals Ltd* [1969] NZLR 955 Woodhouse J ruled that the equivalent New Zealand section was aimed at protecting the interests of contributories and creditors.

In *Re Ferguson; ex p Thome (In Liq)* [1969] 14 FLR 311 at p 316 we find Gibbs J saying (at p 316) that the equivalent Australian section was not enacted for the protection of the company but was passed in the public interest generally. (Emphasis added.)

[16] And also I quote at p 108:

Conclusion

In our view, subs (6) of s 67 creates an important exception to s 24 of the Contracts Act by allowing recovery under an illegal contract, thereby excluding the operation of s 24. A good illustration of the application of such a provision is found in the well-known Privy Council case of *Batu Pahat Bank Ltd v Official Assignee of the property of Tan Keng Tin* [1933] AC 691 per Lord Russell at pp 238–239. In our view, the words of Lord Russell would apply equally to s 67 of the Act. See, also, *Datuk Tan Lay Teck v Sarjana Sdn Bhd & Ors* [1997] 3 AMR 2718 at p 2757 per Augustine Paul JC, as he then was, which is precisely in point.

With the most profound respect, we consider that Chung Khiaw Bank was decided per incuriam because of its failure to actually construe the all important five words 'for which it becomes liable' appearing in subs (6) of s 67. In our view therefore, in a situation where a company obtains a loan from a financial institution on the security of a charge over its land for the purpose of enabling an intending purchaser to purchase shares of the company, the company's liability to the financial institution both in respect of the loan and the security remains unaffected, having regard to the saving provision in the second limb of subs (6) of s 67 of the Act.

Consequently, the borrower company's allegations, even if true, would not provide the existence of 'cause to the contrary' within the meaning of s 256(3) of the Code.

[17] The Federal Court in analysing the effect of s 67 of the said Act took the position that in view of the saving provisions of s 67 of the said Act, civil transactions could be saved thus leaving the directors to be exposed to criminal sanctions, distinguishing our provisions with similar provisions in the

Commonwealth. Based on that, the arguments of the plaintiff of breach of the said Act and illegality of consideration would be a non-starter and I so adopt.

[18] I have already alluded to the purport of the said section and the mischief it addresses. The Federal Court in both these cases have held the civil aspects of the transaction are saved. However, the court still has to examine the facts of each case before it, to see whether the impugned transaction has caused material prejudice to the interest of shareholders and creditors. In my view, the court should take into account the following factors in determining whether material prejudice has occurred:

(a) if the inherent prohibition is to identify a form of activity in which the potential harm to the interests of the company, its shareholders and creditors is so high that it should be struck down;

(b) the transaction would involve the company in the diminution of resources or has the potential to;

(c) the percentage impact on the company's financial position is large;

(d) the transaction will damage the value of the shareholder or creditor's interest; and

(e) the justice of the case requires the transaction to be struck down.

[19] I acknowledge that this is not an exhaustive list but provides a useful guide for the court to act. Accordingly in the case before me. I find none of these factors exists, and on the upshot.

(a) the plaintiff's claim is dismissed with costs; and

(b) judgment in terms of prayer 84(d) of the counterclaim with costs.

Claim dismissed and counterclaim allowed.

Reported by Ashok Kumar